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Regions Financial Corp. (RF)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Regions Financial Corporation's Quarterly Earnings Call. My name is Shelby and I'll be your operator for today's call. I would like to remind everyone that all participant phone lines have been placed on listen-only. At the end of the call, there will be a question-and-answer session. [Operator Instructions]

I will now turn the call over to Dana Nolan to begin.

Dana W. Nolan

Executive Vice President-Head of Investor Relations, Regions Financial Corp.

Thank you, Shelby. Welcome to Regions' second quarter 2018 earnings conference call. John Turner, our Chief Executive Officer, will provide highlights of our financial performance and David Turner, our Chief Financial Officer, will take you through an overview of the quarter. A copy of the slide presentation as well as our earnings release and earnings supplement are available under the Investor Relations section of regions.com.

Our forward-looking statements disclosure and non-GAAP reconciliations are included in the appendix of today's presentation and within our SEC filings. These cover our presentation materials, prepared comments as well as the question-and-answer segment of today's call.

With that, I will turn the call over to John.

John M. Turner, Jr.

President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

Thank you, Dana. Good morning and thank you for joining our call today. Let me begin by saying that we are very pleased with our second quarter results. Our performance clearly demonstrates that we're continuing to successfully execute our strategic plan, building long-term sustainable growth while delivering value to our customers, communities and shareholders.

Our reported earnings from continuing operations of $362 million reflected an increase of 21% compared to the second quarter of the prior year. Importantly, we delivered solid revenue growth while maintaining a focus on disciplined expense management. Of note, adjusted pre-tax pre-provision income increased to its highest level in 10 years. In addition, this marks another very strong quarter with respect to asset quality as virtually every credit metric improved.

In terms of the overall environment, we remain encouraged by improving economic conditions as well as continued improvement in customer sentiment. We remain focused on generating prudent and profitable loan growth, while also meeting the evolving expectations of our customers.

Once again, we are proud of our robust capital planning process. Our planned capital actions receive no objection in the recent CCAR results and we're set to deliver a robust return of capital to our shareholders, while maintaining appropriate levels to meet customer needs and support organic growth.

With respect to our business strategy, we're committed to the diligent execution of our plan and are making notable progress with respect to our Simplify and Grow strategic initiatives. While much has been accomplished, the process is ongoing and we currently have approximately 40 initiatives underway, aimed at accelerating revenue growth, driving operational efficiencies, expanding the use of technology and ultimately, further improving the customer experience.

Through this continuous improvement process, we aim to deliver consistent and reliable results over the long term. For a while now, we've been speaking about four key strengths, we believe, provide considerable momentum for Regions.

First is our asset sensitivity and funding advantage, driven by our low-cost and loyal deposit base. This provides significant franchise value and a competitive advantage, particularly in a rising rate environment.

Second relates to asset quality. We experienced another quarter of broad-based improvements in credit quality and continue to expect modest improvement throughout the remainder of the year. Further, we believe the de-risking and portfolio-shaping activities we have completed, combined with our sound risk management practices, have positioned us well for the next credit cycle.

Third, our capital position supports additional capital returns as we move toward our target Common Equity Tier 1 ratio, the execution of which was again validated through the recent CCAR process. And finally, we expect additional improvements in core performance over time through our Simplify and Grow initiative, which is well under way, as evidenced by our actions today.

As we look ahead, Regions is well positioned and we're building momentum every day. We have clear plans and a strong team and our focus on effectively executing our plans while adapting to the ever-changing environment remains steadfast. We do not anticipate major changes to the company's strategic direction.

Going forward, we will build on the solid foundation already established, delivering consistent and reliable financial results and creating a culture of continuous improvement, our priorities. Providing best-in-class customer service and an unwavering commitment to our associates and communities will not change.

Grayson Hall led the company through one of the most challenging periods in our industry's history. His leadership and commitment has positioned the company well for the future. On behalf of our associates, we thank Grayson for his 38 years of dedicated service and I personally want to thank him for his guidance, counsel and support.

With that, I'll now turn it over to David.

David J. Turner, Jr.

Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

Thank you, John, and good morning. Let's begin with average loans. Adjusted average loan balances increased $382 million over the prior quarter, driven by modest growth in both the consumer and business lending portfolios. Growth in the consumer portfolio was driven primarily by our expanded point of sale partnerships as well as residential mortgage and indirect vehicle lending. Average loan growth in the business lending portfolio was again driven by C&I lending, primarily from our specialized lending areas.

Consumer lending should continue to produce consistent loan growth across most categories and C&I should continue to lead growth within business lending. Headwinds associated with previous de-risking efforts in our investor real estate portfolio have slowed and as a result, we have begun to see a little growth on an ending basis, largely in our term real estate product.

Let's move on to deposits. We continue to execute a deliberate strategy to optimize our deposit base by focusing on valuable low-cost consumer and business services relationship deposits, while reducing certain higher cost brokered and collateralized deposits. As a result, total average deposits declined modestly during the quarter. However, average Consumer segment deposits experienced solid growth of over $1 billion, consistent with our relationship banking focus.

Our deposit advantage is generated from our granular and loyal deposit base. During the second quarter, interest-bearing deposit costs totaled 38 basis points, while total funding costs remained low at 52 basis points, illustrating the strength of our deposit franchise.

Cumulative deposit betas through the current rising rate cycle are only 14% and importantly, consumer retail deposit betas remained low at approximately 1%. As expected, commercial deposits have been more reactive with a cumulative beta of approximately 44%, driven primarily by large corporate and brokered deposits. We believe our large retail deposit franchise differentiates us in the marketplace. As such, we're in a position to maintain a lower deposit beta relative to peers.

Our customer base is also highly engaged with over 55% of consumer checking customers utilizing multiple channels and more than 75% of all interactions are now digital. The number of active mobile banking customers has increased 12% compared to the prior year and active mobile deposit customers has more than doubled. We continue to focus on being our customers' primary bank as 93% of our consumer checking households include a high-quality primary checking account.

So, now, let's look at how all this impacted our results. Net interest income increased 2% over the prior quarter and net interest margin increased 3 basis points to 3.49%. These increases were driven primarily by higher market interest rates and prudent deposit cost management.

With respect to full year 2018, the current market expectation for the Fed to continue increasing rates, combined with better-than-forecasted deposit pricing, will likely push NII towards upper-end of our 4% to 6% guidance on a non-fully taxable equivalent basis.

Specific to the third quarter of 2018, current market expectations for a rate increase in September, along with similar deposit betas to what we have experienced in recent quarters, are expected to result in another solid quarter of growth in net interest income, along with modest net interest margin expansion. Remember, the third quarter will have one additional day that will benefit net interest income, but reduce net interest margin.

We also experienced a good quarter as it relates to fee revenue. Adjusted non-interest income increased 2% with growth across most non-interest revenue categories during the quarter. Keep in mind, the first quarter benefited from net gains associated with the sale of certain low income housing investments and deposit valuation adjustment associated with a private equity investment totaling $13 million that did not repeat this quarter. These gains were included in other non-interest income.

With respect to corporate fee revenue categories, the company's investments in capital markets continue to pay off as the business delivered another record quarter. Revenues totaled $57 million, with all businesses within capital markets contributing. The second quarter increase was led by merger and acquisition advisory services and customer derivative activity.

Consumer categories remain an important component of fee revenue. To that point, service charges and card & ATM fees grew by 2% and 8% respectively. This growth has been aided by year-to-date checking account growth of approximately 1.2%. In addition, revenue growth was supported by an increase in debit transactions of 9% and an increase in credit card spending of 10% during the second quarter.

Mortgage income remained stable during the quarter despite seasonally higher production, due primarily to a 25 basis point reduction in gain on sale. While production is lower across the industry, we continue to expect better performance relative to peers due to our historically higher mix of purchase versus refinance volume.

We continue to evaluate opportunities to grow our residential mortgage servicing portfolio. And during the quarter, we reached an agreement to purchase the rights to service approximately $3.6 billion of mortgage loans with an expected close date of July 31, 2018, and is subject to customary closing conditions. Increasing servicing income is expected to help offset the impact of lower mortgage production. Wealth management income was up modestly in the quarter, driven by 12% increase in investment services fee income.

Let's move on to the expenses. On an adjusted basis, non-interest expense increased approximately 2%, attributable primarily to increases in professional fees and expense associated with Visa class B shares sold in a prior year. Excluding the impact of severance charges, salaries and benefits decreased approximately 1%, reflecting staffing reductions and lower payroll taxes, partially offset by annual merit increases.

As a result of our efforts to rationalize and streamline our organization, staffing levels declined by 340 full-time equivalent positions compared to the prior quarter and approximately 1,100 full-time equivalent positions compared to the second quarter of the prior year.

Year-to-date, full-time equivalent positions have declined by approximately 700 positions. Further salaries and benefits expense reductions are expected in the third and fourth quarters as approximately 500 additional position reductions will benefit the run rate. Keep in mind, these numbers do not include the 644 position reductions associated with Regions Insurance.

In addition, we continue to take a hard look at occupancy expense and will exit approximately 500,000 square feet this year, benefiting 2019 and beyond. This amount does not include another 200,000 square feet of reductions associated with Regions Insurance.

The adjusted efficiency ratio was 60.4%, down slightly from the prior quarter. And through the first six months of 2018, the company has generated 2.7% of adjusted positive operating leverage. For full-year 2018, we continue to expect adjusted positive operating leverage of 3% to 5%, relatively stable adjusted expenses and adjusted efficiency ratio of less than 60%.

So, let's shift to asset quality. Broad-based asset quality improvement continued during the quarter. Non-performing, criticized and troubled debt restructured loans as well as total delinquencies all declined. Non-performing loans, excluding loans held for sale, decreased to 0.74% of loans outstanding, the lowest level since 2007.

Net charge-offs totaled 32 basis points of average loans, an 8-basis-point decline from the prior quarter's adjusted ratio. The provision for loan losses approximated net charge-offs during the quarter and included the release of our remaining hurricane-specific loan loss allowance of $10 million. The allowance for loan losses totaled 1.04% of total loans outstanding and 141% of total non-accrual loans.

Let me give you some brief comments related to capital and liquidity. As John mentioned, we are pleased with our CCAR results and remain committed to maintaining prudent capital ratios while thoughtfully investing in our businesses for future growth and delivering a solid return of capital to our shareholders.

On July 2, we completed the sale of our Regions Insurance subsidiary. The after-tax gain associated with the transaction was approximately $200 million and Common Equity Tier 1 capital generated was approximately $300 million.

Our capital plan incorporates the capital generated from this transaction and is included in our board-authorized share repurchase program for up to $2.03 billion in common shares over the next four quarters. Subject to our board's approval, the plan also includes a 56% increase in Regions' quarterly common stock dividend to $0.14 per share, beginning in the third quarter.

Regarding 2018 expectations, our full-year expectations remain unchanged and are summarized again on this slide for your reference.

So, in conclusion, we are pleased with our second quarter results and believe our Simplify and Grow strategic initiative, along with other opportunities and competitive advantages, position us well for the remainder of 2018 and beyond.

With that, we thank you for your time and attention this morning and I'll turn it back over to Dana for instructions on the Q&A portion of the call.

Dana W. Nolan

Executive Vice President-Head of Investor Relations, Regions Financial Corp.

Thank you, David. As it relates to Q&A, please limit your questions to one primary and one follow-up to accommodate as many participants as possible. We will now open the line for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Your first question comes from John Pancari of Evercore ISI.

John Pancari
Analyst, Evercore Group LLC
Q

Good morning.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Good morning, John.

John Pancari
Analyst, Evercore Group LLC
Q

On the loan growth front, wanted to see if you can give us a bit more color on where you see the drivers of loan growth through the back half coming from and your full-year outlook of low-single digits. It seems like at this point, you might be trending at the lower-end of that. Do you see it that way or do you think it can break to the upside a little bit through the back half? Thanks.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Well, I would say, first of all, we are affirming our current guidance for low-single-digit loan growth excluding the runoff that's targeted in indirect portfolio and the TDR sale obviously. If I focus on the consumer side of the business, we feel pretty good about our forecast. We look at mortgage, we expect it to generally be flat, I think. We see runoff in the HELOC portfolio and the balance of our consumer business should grow modestly, we believe, across most of the sectors in the remaining part of the year.

On the corporate side of the business, our pipelines are good. They have improved since the first quarter and they continue to be pretty solid. Our customers are optimistic, but I would say, they're still a bit cautious. We're seeing customers use a lot of their liquidity to fund their additional borrowing needs or what would have traditionally been additional borrowing needs and you can see that in some of our runoff in our deposit balances.

But generally, if you think about our business in the three segments that we think about, the corporate banking business, I think, will grow modestly through the balance of the year, largely as a result of activity within our Specialized Industries group and a more narrow targeted focus by our diversified industry bankers. And we've seen both those teams have some success in the first part of the year.

In the traditional middle market, commercial banking and smaller business banking, we have a renewed focus there that we're beginning to see really get some traction. Owner-occupied real estate, which had been running off at a pretty rapid rate through, I guess, over the last 10 years has really begun to slow and that will help us, we believe, see some additional loan growth through the balance of the year.

And then, finally, in real estate, we had indicated we thought, in the second quarter, we would begin to see some modest growth. If you remember that we had been de-risking that portfolio, exiting many of the multi-family construction loans that we had on the books and that has been successful, I think. Term lending, while it's very competitive, has begun to have a positive impact on our portfolio. And so, we saw some nice loan growth at the end of the quarter in real estate banking.

And so, all-in-all, I think our guidance is solid. I would not say that we, at this point, would guide toward the upper-end of the range. I think it would be lower-end to the middle of the range, but we do believe that we will achieve those objectives. And if we do, we will meet all of our other targets as a result of that.

John Pancari
Analyst, Evercore Group LLC

Q

Okay. That's helpful. Thank you. Then, in terms of your margin, saw some pretty good expansion again this quarter and probably would have even been higher, if not for the leveraged lease transaction, but I just want to – or the impairment that is. I want to get your updated thoughts on the sensitivity to the ongoing Fed moves, but also rising betas. What's your updated sensitivity to each incremental 25-basis-point Fed hike?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

Yeah. I think, John, so, this is David, our expectation for the year is – our beta, thus far, is 14%, as I mentioned earlier. We do think that picks up in the back half of the year, but if we look at 2018, we think of beta in the 30% range is what's baked into the guidance that we've given you.

Thus far, we've outperformed our expectation on beta and rates have come in faster than we had anticipated as well. And so, we're reiterating our guidance on net interest income growth this year to the higher-end of that 4% to 6% range. We think we can get the higher-end of that.

As it relates to next quarter, we think we'll have another solid quarter of growth in NII and we think our margin will grow modestly, because it has to overcome about 2 points for the next quarter for the head count. So, I think that we feel very good about our expectations.

John Pancari
Analyst, Evercore Group LLC

Q

Okay, David. Thank you.

Operator: Your next question comes from Jennifer Demba of SunTrust.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Good morning, Jenny.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you. Just wondering if you could clarify what your M&A interest and capacity is at this point.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Sure. We have an M&A team and they're charged with finding both bank and non-bank opportunities. And we've had some success acquiring non-bank businesses, mortgage servicing rights and other loan portfolios. In fact, we point to BlackArch Partners and that investment as being a real high point in the quarter in terms of their contribution. And we'll continue to look for those kinds of opportunities, because non-bank opportunities help us fill gaps in our capabilities, meet customer needs and importantly, grow and diversify revenue.

Bank M&A is a good bit more challenging. When we think about where Regions trade relative to our peers, we're trading – or relative to targets, I would say, likely targets, we're trading at a discount. And as a result, the economics just don't work for us. We look at our plans and our opportunities and we think they are significant. We benefit from rising rates. We have a good plan to return capital to our shareholders, which should generate outsized returns. We think, through our Simplify and Grow initiative that there's a real opportunity to improve our core business.

And so, we're just not going to do a transaction that would be significantly dilutive to our shareholders in this environment. Now that's not to say that we're not going to continue to look, we will do that, we learn as we do, but I think we're going to be very conservative and very thoughtful. We'll seek to build relationships with potential sellers. We'll watch the market, but we're going to be very disciplined in that regard, principally because, again, we have the opportunity we think to take advantage of a number of other levers that will drive outsized returns for our shareholders.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc. Q

Great. Thank you for the update.

Operator: Your next question comes from Ken Usdin of Jefferies.

Ken Usdin
Analyst, Jefferies LLC Q

Hi. Thanks, guys. In terms of the balance sheet mix, you haven't had a lot of earning asset growth, which has allowed you to be, I think, in part so disciplined on the deposit side. How much more shrinkage do you think you could see in terms of the non-interest-bearing deposit side? And at what point do you think that you might have to just go out into the market just to keep up with what hopefully is now a better trajectory on the loan growth side?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp. A

Yeah Ken, this is David. So, you mentioned us being disciplined on pricing on the deposit side, but I would tell you, we've been very disciplined on the left side of the balance sheet. We want to grow loans. We did grow loans this quarter, but we are going to remain very disciplined in making sure that when we lay our capital to our customers to serve their needs that we are paid and we have an appropriate return on that capital that we put out.

We have a low loan deposit ratio relative to our peers and staying disciplined on the left side of balance sheet lets us be even more disciplined on the right side. You are correct to see that non-interest-bearing deposits have been put to work. A lot of that has been on the corporate banking side, where corporate banking customers are looking for alternatives to generate yield. Some of that's gone into interest-bearing accounts with us. Some of that's been utilized, as John mentioned earlier, to fund capital expenditures and put the excess cash to work, but at some point, we believe those actions will dissipate and we'll be able to grow loans.

We are constantly looking for relationship deposits. Whether it'd be on the consumer side or the business service side, that will always be important to us, but we don't see any need in the near term to have to go out and bid up deposits from a cost standpoint. That being said, we do have promotions like others do and we'll look at opportunities to strengthen the market, leveraging that, but wholesale changes in our deposit structure is not in order at this point.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Yeah. And I'd just make another – maybe two points, Ken. One is if you look at growth in consumer deposits, we grew demand deposits in the consumer business by 6.4% year-over-year and continue to see good growth in checking accounts and households. And so, we believe that we'll see nice steady growth in consumer deposits.

The second thing I'd say is we are, again, reiterating our guidance for low-single-digit deposit growth through the end of the year. And so, we do expect that we'll continue to grow deposits and finish the year with a little growth.

Ken Usdin
Analyst, Jefferies LLC
Q

Understood. Okay. Thanks, guys.

Operator: Your next question comes from Steve Moss of B. Riley FBR.

Steve Moss
Analyst, B. Riley FBR, Inc.
Q

Good morning. On the commercial real estate growth here, I was just wondering we've heard more comments around competition and tighter spreads, wondering what you guys have seen as it relates to that and what types of properties are driving growth.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Yeah. So, a great question. We are seeing a lot of competition. Particularly in that term lending product, spreads that compressed 50 basis points or more since the beginning of the year. We've had to be very selective in seeking out opportunities in this space. The growth we've had, though modest, has been in multi-family and office primarily where we think we have a good expertise. Just mind of the audience that we have been managing that portfolio very actively for quite some time and today, it represents about 7% of our total loan portfolio down from at one time, Barb?

Barbara I. Godin
Senior Executive Vice President, Chief Credit Officer & Member-Operating Committee, Regions Financial Corp.
A

In the 30%...

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.
A

30%.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

In the 30% range back during the crisis. So, we believe it's a business that we can and will continue to grow modestly. It provides really nice fee income opportunities for us and you see that in our capital markets business and it improving, also presents an opportunity for us to grow deposits as we begin to develop more relationships with the owner-operator customer who is the term lending customer. So, we'll grow it modestly, but carefully, and again manage it, I think, very judiciously.

Steve Moss

Analyst, B. Riley FBR, Inc.

Q

Okay. That's helpful. And then, on the securities portfolio here, wondering what your thoughts are on balances going forward as the yield curve has narrowed. And what are your thoughts, if it inverts you in next couple of quarters?

John M. Turner, Jr.

President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Yeah. So, in terms of the level of securities as a percentage of earning assets, we don't anticipate any significant change there. If we do get some liquidity, LCR relief, we may change out some Ginnie Mae securities and put them to work more effectively. But right now, we think that just continuing to manage the book like we are with the same duration.

We have a lift coming from our fixed rate lending and our securities book even if rates stay flat to where they are right now as we rerate some $12 million to $14 billion worth of assets over a given year. So, an inversion, that you spoke of, we think would be more central bank driven than a precursor to a downturn. And even with that, as rates have shifted up and the repricing comes through, we still have a very significant tailwind to help us continue growing NII.

Steve Moss

Analyst, B. Riley FBR, Inc.

Q

Okay. Thank you very much.

Operator: Your next question comes from Saul Martinez of UBS.

Saul Martinez

Analyst, UBS Securities LLC

Q

Hi. Good morning, everybody. I wanted to ask about the loan yield. Your C&I yield, obviously, picked up with the higher rates, but significantly less, I think, than a lot of other banks, who benefited from this blowing out of LIBOR relative to the Fed Funds rate. Maybe the leverage lease trend write-down had, maybe on the margin, something to do with it. But I'm curious why you're not seeing a bit more of a yield pickup as some of your competitors have and does it have to do with hedging strategy? Does it have to do with the structure? But it's been, over the last few quarters, about 10 bps sequential with every rate hike. So, I'm curious why – if there's something there that is different about your C&I book or how you manage through the portfolio.

John M. Turner, Jr.

President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Yeah. I'll take a shot at that and maybe David can follow. Typically, I mean, our C&I business has been very much a relationship-oriented business. Going back a very long time, it's generally built around our core markets, Alabama, Mississippi, Tennessee, where we have very long and deep relationships. We enjoy significant demand deposits associated with those relationships in that business. And while we don't – as we look at our peers typically, don't get the same yield on the loan side of our business, we enjoy, we think, greater demand deposits. And so, view it from a relationship perspective, we think that there's fair tradeoff there. That's part of it.

Another part of it is that we have been seeking to grow both our government and institutional banking business, which is a little more competitive and yields are narrower. And separately, we've been working hard to stem the tide of runoff in our owner-occupied real estate portfolio. And so, deals there have been compressed a bit too.

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.
A

I'll add the other thing is really you got to look at the whole relationship versus picking apart loan side versus the deposits. But we didn't have the leveraged lease impairment, $5 million you pointed out, that's about 3 basis points of that change too. So, that's the other piece of this.

Saul Martinez
Analyst, UBS Securities LLC
Q

Yeah. It's just kind of hard to triangulate, though, with some of your peers having 30 bps, 40 bps, 30-plus bp yield pickup sequentially, pointing to the higher LIBOR and you guys have been pretty consistent at 10-basis-point per quarter when you have a rate hike.

So, everything you said makes sense, but I wonder if there's anything – it has anything to do with how you – is it hedging strategy or the structure of the loan? Because it seems like there's a bit of a disconnect versus what we've seen some of the other banks report.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Yeah. So, you've got to look at mix. You have to look at everybody's hedging strategy, but you look at our asset sensitivity, 25% of it is on the short term, 25% of it is in the middle term and 50% is on the long-end. So, that will have a little bit of a dampening impact in terms of rate increases that move up. And so, I think that it's really hard to compare peer-to-peer. There are a lot of puts and takes on it.

Saul Martinez
Analyst, UBS Securities LLC
Q

Yeah. Fair enough. If I could just get in a quick one, the indirect-other consumer obviously growing pretty well with the GreenSky, but where do you think – can you remind us where you think that book can grow to in terms of absolute size over the next year or two?

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Yeah. So, we do have limits in terms of how much we want our indirect-other to get to. Right now, our indirect-other consumer is about $1.7 billion. We're looking at that number to be in that $2 billion range. So, some growth there, but not an extraordinary growth.

Saul Martinez
Analyst, UBS Securities LLC
Q

$2 billion by year-end?

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

I would say over time. Yeah.

Saul Martinez
Analyst, UBS Securities LLC
Q

Okay. Got it. Thanks a lot.

Operator: Your next question comes from Geoffrey Elliott of Autonomous Research.

Geoffrey Elliott
Analyst, Autonomous Research
Q

Hello. Thank you for taking the question. Maybe following up on the earlier discussion on M&A, can you kind of outline both on the non-bank side and the bank side either from a product point of view or geography point of view? Are there areas where if the price was right and the economics were right, you'd be particularly interested from a strategic perspective?

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

I'm happy to. With respect to non-bank, I think our focus has been on, as I said earlier, adding capabilities, so whether it'd be in capital markets or in wealth management as an example, adding products and capabilities that help us fill gaps to meet customer needs. We've been acquiring loan portfolios, more servicing rights and those things and we'll continue to do. We have capacity within our mortgage servicing operations. We think we do that well and so we will continue to likely add to that portfolio.

On the bank side, I think typically our interest is going to be in footprint. We talk about size and I think that that ranges, but our conversations have been in the $3 billion to $15 billion kind of range. We're not interested, as I said earlier, in doing a transaction that would be significantly dilutive to tangible book value and earn-backs are important to us. I hope that gives you a little bit of perspective.

Geoffrey Elliott
Analyst, Autonomous Research
Q

Got it. That does. And then, a quick one on CCAR. It looks from the CCAR results like there's some preferred issuance baked into the ask, as I think that was last year as well. Could you discuss a little bit – well, firstly, confirm that's the case and then discuss the circumstances when you'd be expecting to issue preferred?

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Yeah. So, Geoffrey, originally, we had a preferred issuance built in, but that was in 2019. We do need to continue to watch changes, regulatory changes, with regards to the SCB in terms of how that might impact our capital ratios in terms of will it have us – have more common and therefore negate the need to have preferred stock over time. There's more to come there, but we want to make sure that also we have an appropriate amount of capital Tier 1 and Common Equity Tier 1.

Our focus right now in the short term has been to get our common equity down to our 9.5% target range. And as we do that, we need to make sure we backfill appropriately for Tier 1. And if we don't get relief through the SCB, then we'll have preferred issuance in there right now pegged in 2019.

Geoffrey Elliott
Analyst, Autonomous Research
Q

Thank you.

Operator: Your next question comes from Matt O'Connor of Deutsche Bank.

Matthew O'Connor
Analyst, Deutsche Bank Securities, Inc.
Q

Hi.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Yeah, hi Matt.

Matthew O'Connor
Analyst, Deutsche Bank Securities, Inc.
Q

I was wondering if you can talk about the kind of relationship of provision expense to charge-offs look out the next few quarters. Obviously, this quarter, it was very closed to matching after a couple quarters of release, but with loans starting to grow again here, I'm wondering if you can give some color on that.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Barb?

Barbara I. Godin
Senior Executive Vice President, Chief Credit Officer & Member-Operating Committee, Regions Financial Corp.
A

Yes. I think you'll continue to see us match provision to charge-off and there could be a slight build relative to loan growth as one would expect.

Matthew O'Connor
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. And in terms of the loans that you're adding now, say, the indirect consumer, which isn't that big, but the growth that you're getting there and from some of the other portfolios, are they – do you think the loss content of what's being added is higher than what's running off or is there still some kind of underlying de-risking as say home equity runs off and things like that.

Barbara I. Godin
Senior Executive Vice President, Chief Credit Officer & Member-Operating Committee, Regions Financial Corp.
A

I think we're going to continue to see some modest improvement in our numbers across all of our portfolios over the balance of the year definitely and what we're putting on the books is of very high quality, very happy with it.

What we're seeing with those loans is, in fact, they are performing very well and we would expect them to continue to perform well, including better than those that are running off.

Matthew O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thank you.

Operator: Your next question comes from Betsy Graseck of Morgan Stanley.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Good morning, Betsy.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Good morning.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

I know that there is – you mentioned briefly some – what the trajectory of Simplify and Grow is. So, maybe you can give us a little bit of color as to the kinds of actions that have been taken over the past quarter or so and how you expect the operating leverage trajectory to shift from here. Is it at the run rate that we've been seeing over the last year or so or do you feel that we're moving into a period where there could be a little bit more acceleration in that trajectory?

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

John Owen is leading that work. I'll ask him to answer your question and maybe David can follow on as well.

John B. Owen
Senior Executive Vice President, Head-Enterprise Services and Consumer Banking & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

Yeah. Good morning, everyone. We're making good progress on Simplify and Grow initiative. As we said earlier, we've got about 40 initiatives that are underway. We started this about seven months ago and I think we're off to a really good start. Let me give you a couple of examples of projects we have underway. I think that might provide some color and background.

First one to focus on would be our consumer lending space. We've got a team working on how do we take all of our consumer lending categories and make them fully 100% digital, meaning a customer can come in, start a digital channel where it's mobile device, iPad or laptop, start there and finish that loan completely digital. We're going to do that for all consumer loan categories. We're well down the road in that process. I would tell you, by the end of 2018, we'll have the majority of that work done.

Maybe some things will spill over into 2019, but an example of some of the changes we made, I'll take the mortgage application process. We've re-engineered that process. We've gone through and taken out about half of the data requirements for the application and it's taken the application time down from over 15 minutes to under 5 minutes.

The other thing we're seeing is a huge shift in adoption in terms of filling out your application in digital format. In December, only about 20% of our apps were filled out in the digital space. We're now about approaching 60% of our applications filled out in that digital space.

The other one I would point out, another initiative is in our commercial lending process. We've gone through and really put a dedicated team focused at how do we re-engineer that process, really with the goal being for us to get a faster answer back to customer. So, from application time to a yes or a no to a customer, we've dropped that by about 70%. And so, the team has done a great job of making banking much easier for our commercial customers.

The last one I'd point out would be in our contact center area. We've gone through and used IBM Watson in our contact center really to provide some assistance to our reps, so they can better assist our customers. Couple use cases that we have deployed, the first being for certain call types, Watson will actually take the call, handle the call with the customer and service that call right there with Watson. We've had about 700,000 calls already year-to-date that Watson has handled that call from start to finish and that's equivalent to about 55 contact center reps in that initiative alone.

The other thing we've done is we've gone through and really tried to arm our reps to be able to have quick, fast answers back to customers. And we have Watson set up almost in a chat mode. So, a customer – I mean, a rep can actually ask Watson a question when they have a customer on the phone. They've done that 700,000 times year-to-date. And so, a lot of good work there, a lot of good energy.

As David mentioned earlier about head count and one of the things that when you think about head count and I'll say corporate real estate, those are two big indicators that you can watch to see us where we're making progress on our Simplify and Grow strategy. We're down about 770 positions through June and that's a direct result of management actions that have been taken with these 40-plus initiatives that are out there.

Also Regions Insurance closing on July 2, that's about 644 positions eliminated there. And in the balance of the second half of the year, you'll see Simplify and Grow impact probably another 500 positions in the second half of this year. That's over 1,900 positions. And what I would tell you is that will really show up in 2019 when we get the full run rate.

The last point I would make would be on the real estate side. We've got a good opportunity to continue to reduce our space across the bank. We'll be down about 700,000 square feet this year. We expect that trend to continue.

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

So, Betsy, I'll add to that. So, our operating leverage today is 2.7%. We are reiterating our guidance of 3% to 5% for the year. We get there both by having improvements in revenue whether it comes from rate, balance sheet growth, Simplify and Grow initiative helps revenue and then continuing to watch our cost for the remainder of the year. You'll see the benefit that, as John just mentioned, really ramp up in the third and fourth quarter, such that it gives us confidence that not only are we going to meet our operating leverage target, but we'll also get our efficiency ratio below the 60% level.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Got it. That was really helpful color. It sounds like you were well-prepared for that question. Yeah.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

[indiscernible] (45:52).

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Exactly. One other just a separate topic, but, David, on the capital, I know we talked a little bit about capital and capital return already, just – especially since the Insurance acquisition – or Insurance, sorry, sale is happening this year, is there any opportunity to do a mid-quarter ask or a de minimis as well in terms of a capital return?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

Well, so we had baked into our submission to the extent we generated capital that we were also going to be able to include that. And that is in the numbers that you see. So, that $300 million has already been asked for. So, there's no need to go back. There's always an opportunity to go back on a de minimis. The de minimis is a fairly small number now. And we'll have to see circumstances changes. We did not anticipate that, but it's always an option.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you.

Operator: Your next question comes from Peter Winter of Wedbush.

Peter J. Winter
Analyst, Wedbush Securities, Inc.

Q

Good morning.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Good morning.

Peter J. Winter
Analyst, Wedbush Securities, Inc.

Q

I just wanted to follow up on the efficiency ratio looking out longer term, if you're still targeting bringing it down to the mid-50s and over what timeframe do you think you can get there.

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

Yeah. Peter, that's a good question. So, we've been pretty focused on our 2018 to kind of make sure we meet that. It's the third year of our three-year plan we laid out in Investor Day in November of 2015. Now, we are going to have our Investor Day in February of 2019 where we will have our scorecard. I won't be going through what we're going to do and that we're going to be laying out expectations for the next three years.

You've heard me mention before I think our industry is going to have to become more efficient over time and I think we will certainly do that. And I think targeting something in the mid-50s to maybe even better than that over time is on the table.

I think you should see us through Simplify and Grow initiatives to get just a little better each quarter, but when can we hit that mid-50s? We haven't really gone out and said that. You're going to have to wait and show up in February to hear it, but I think in the not-too-distant future, we could actually get there.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Yeah. I would just reiterate that. I think we're very focused on continuing to improve the efficiency of our operation and we'd make the point that our Simplify and Grow initiative, we've tried to be clear that it's not a program. It's really about making a cultural shift here at Regions. It's about developing a culture of continuous improvement. We've got to always be looking for how do we make it easier for our customers and bankers to do business, how do we improve our processes, how do we drive efficiency to be more effective and deliver more value for our shareholders? So, we're very committed to doing that.

Peter J. Winter
Analyst, Wedbush Securities, Inc.
Q

That's really helpful. And just a follow-up, if I look last year, the share buyback coming out of CCAR, you frontend loaded that buyback. Should we expect kind of the similar type trend this year?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.
A

Well, we haven't laid out our timing, Peter, but we have a pretty tall order to get that done as soon as possible and that's our goal. We're carrying excess capital right now that's really been an anchor from a return standpoint and we would like to get that capital right-sized sooner rather than later. And so, I'll leave it at that.

Peter J. Winter
Analyst, Wedbush Securities, Inc.
Q

Perfect. Thanks very much.

Operator: Your next question comes from Erika Najarian of Bank of America.

Erika Najarian
Analyst, Bank of America Merrill Lynch
Q

Hi. Good morning.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Good morning.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Just one follow-up question from me. You mentioned that 93% of your consumer deposits have high-quality checking accounts tied to them. Obviously, the consumer beta stands at 1% on the cumulative basis. I guess I just wanted to make sure I'm understanding the message correctly. A lot of your peers are starting to guide towards more aggressive betas going forward. Is it that a lot of your consumer retail accounts are transactional and don't have that excess cash that potentially could rotate away from Regions into some of these online offerings? Are we reading that correctly?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

Now, that's a big piece of our deposit base and that's why it's been fairly stable. That's why it was – our beta was low last time. That's why we think it will be low this time. And we have the core checking account of our consumer base and that is really, really important, very granular, average deposit of about $3,500 on account. So, that's what makes us unique and that's how we'll win from a beta standpoint.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Great. Thank you.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Thank you.

Operator: Your next question comes from Christopher Marinac of FIG Partners.

Christopher William Marinac
Analyst, FIG Partners LLC

Q

Thanks. David, I had a similar question as Erika, but just want to look at it from the angle of the non-metro markets. To what extent does that keep working for you as we get further along in the right cycle? Is that still a benefit that you have?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

Yeah, absolutely. We think it's foundational to who we are and non-metro markets, that's a big part of our deposit base. It's not just deposits, but it's the whole relationship that we have with these customers that are very loyal to us. And we dominate in those markets.

So, it's important for us to continue to provide good, solid customer service and we will retain those deposits, which we think, again, is foundational and really is the differentiator. We've had this strategic advantage for a long time, but without rates rising some, we couldn't extract the value until now. And so, we think that continues on in the future.

Now, the offset to that is our deposit growth relative to some of those smaller markets isn't as robust as some of the major metros, which is why you have seen us make some investments in major metros like Atlanta, where we can capture some of that faster growth, but we don't want to abandon that core customer base in the smaller markets. So, that's really our strategy on both sides.

Christopher William Marinac
Analyst, FIG Partners LLC

Q

That's very helpful. Is there a way to pinpoint the kind of rate advantage between metro versus non-metro, even in just in the big-picture context?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

We can get back to you on that, Christopher.

Christopher William Marinac
Analyst, FIG Partners LLC

Q

Okay. That's great. Thanks, guys. Appreciate it.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Thank you.

Operator: Your final question comes from Gerard Cassidy of RBC.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Good morning, guys. How are you?

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

A

Good morning, Gerard.

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

Good. Thanks.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

David, can you share with us – in the securities portfolio, I think you said that about $12 billion to $14 billion reinvest every year. Did I hear that correctly?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.

A

That's total assets, Gerard.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Oh, okay.

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.
A

Yeah. It's probably $2 billion, $3 billion in the securities book and about $10 billion, $11 billion in the loan book.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Okay. In the securities book, what yields are you giving up when it rolls off and what are you reinvesting it in and what is the duration of that portfolio as well?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.
A

Yeah. So, our duration really hasn't changed over time. We're in 4, 4.5 years in terms of duration. What's rolling off is in the 250 range and what's going on is about in the 315 range. So, that was one of the benefits of rates just stay here. That reinvestment of maturities, again both in securities and loans, is a big benefit to us.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Very – very true. And then, circling back to deposits, one of your peer banks talked about they're seeing their commercial customers using their cash for capital expenditures, which is one of the reasons they felt their commercial loan growth was a bit modest. Is there any evidence with your corporate and commercial loan book in talking to your customers that they're drawing down on their deposits for capital expenditures and down the road, you might see the loan growth as they used up those excess deposits?

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.
A

Gerard, this is John. Yeah, we think that is exactly the case. And we would point to $500 million more or less in deposit declines that we think have been directly related to customers putting that to work. That's sort of a – that's a more specific number than it ought to be more of a round number, I guess, but that – kind of the runoff that we've seen has, I think, largely been, we believe, used by customers to invest in their businesses. And as a result, at some point, we think that will translate into additional loan growth.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Right. Okay. Thanks. And then just lastly, David, you mentioned that you're outperforming on the beta. Have you guys figured out why the beta so far this year has just moved so slowly? Is it just the nominal rate of interest rates being so low or is there another factor?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer & Member-Executive Council and Operating Committee, Regions Financial Corp.
A

Well, I think for us, if you look at our retail base betas of 1%, it gets back to the makeup of our deposit base and who our customers are which was really Chris' first question I was trying to answer. If you go to the business side, we've had cumulative beta of about 44%. Those are oftentimes large corporate customers that are looking every time rates go up for their fair share. And I think that we have to be prepared for that just like we are on competitiveness from a loan pricing standpoint.

But what differentiates us is our intense focus on relationship banking. Whether it be on the consumer side, the business services side or the wealth side, it's really important for us to maintain that relationship and have all the products and services delivered to our customers. And we think that's what helps keep us – keeps our beta down as well.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Great. Thank you.

Operator: I will now turn the call back over to John Turner for any closing remarks.

John M. Turner, Jr.
President, Chief Executive Officer, Director & Member-Operating Committee and Executive Council, Regions Financial Corp.

Just thank you all for participating today. Appreciate your time. Thanks for your interest in Regions.

Operator: This concludes today's conference call. You may now disconnect.